

World Financial Crisis as an Accelerator for Belarus' Reforms?

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Rezume

The world financial crisis was sparked off just as Belarus started to gradually internationalize its economy and slowly integrate into the global financial community. The country has so far showed a modest degree of integration, however, the factors through which world economic variations impact Belarus are not at all dependent on Minsk-based decision-makers, which means the only way out for the Belarusian authorities and economic entities is to try and adapt. The Belarusian administration has to come to terms with the inevitable while making adjustments to structural and political aspects, such as its commitments to society, as the crisis pushes Belarus towards transformations, especially, privatization. The ideological pressure the authorities have put on the community in order to legitimize the new economic model is ample proof of the need for reforms.

Is the crisis “external”?

The soft monetary policy pursued by the U.S. for many years with a view to encouraging the domestic demand and promoting money turnover has finally brought about certain problems. The trouble did not immediately affect Belarus, since our financial miracle has different origins: the gap between loan and deposit growth rates and rise in labor productivity is growing bigger amid the surging deficit in foreign commodity trade.

The basis of various processes is the same, though, because the credit behavior of Belarus' individuals and economic entities has ultimately matched global trends: those who borrow more are not any longer regarded as miserable, suspicious or unreliable. To live “against credit” is quite normal now, contrary to what it felt like a few years ago. As there is no securities market in the country, the head of state may resort to a rhetoric that tags the crisis as an “external” phenomenon. Meanwhile, statistically our foreign trade figures are all denominated in the U.S. dollar... Furthermore, we naturally border on the foreign world, and across this border flow commodities, money and information. It seems to call the crisis an “extraneous” occurrence would be the same as to breathe the air around us while calling atmosphere a “foreign” factor. Let's have a better look at imports and exports. They have been growing over the past 14 years, and so has the throughput capacity of the channel, which our neighbors' predicaments are making use of to crawl into Belarus. This happens through dwindling consumption of Belarusian export supplies or change in prices of things we traditionally import.

Table 1. Major foreign trade indicators, millions of U.S. dollars

	1995	2000	2005	2007
Commodity exports, including	4,803	7,326	15,979	24,275
to Russia	2,185	3,710	5,716	8,879
to the "West" (the U.S., EU)	1,776	2,927	8,919	13,054
Commodity imports, including	5,564	8,646	16,708	28,693
from Russia	2,965	5,605	10,118	17,205
from the "West" (the U.S., EU)	1,887	2,576	5,566	9,677

Source: National Statistics Committee of the Republic of Belarus

Referring to Table 1 it can be seen that in the middle of the period under review, not without the effects of the 1997-1998 crisis, trade tendencies reversed: exports to Russia went below the volume of supplies to the West, while imports from Russia started growing rapidly. The key reason behind the transformation was prices for crude oil and fertilizers.

The constant growth in these prices brought about changes in the commodity structure of exports (see Table 2), and additional currency resources appeared in the country to partially resolve some of the domestic problems. The increase in currency proceeds (Table 1), inflows of cash resources from foreign migrants (their annual average number, in terms of the full working year, stood close to 250,000 people in the past five years), and the external debt growth (Table 6) have been stable enough to keep the Belarusian ruble strong against the U.S. dollar and consistently augment gold and foreign exchange reserves of the National Bank (see <http://www.nbrb.by/statistics>).

Table 2. Commodity export/import structure in 2007, per cent of the total

	Export	Import
Foods and agricultural raw materials	7.5	7.9
Other commodities (timber, construction materials, fabrics)	19.9	19.8
Machines, equipment, and vehicles	22.3	24.7
Mineral products and chemicals	51.3	47.6

Source: National Statistics Committee of the Republic of Belarus

The decay of the abovementioned factors will have various consequences, therefore, the key challenge of the crisis that Belarus is supposed to respond to is to determine the resultant vector of potential changes. We start with crude oil and oil products, potash fertilizers, natural gas and two leading economic indicators of the domestic market, namely, the demand for dwelling, new cars and computers (Tables 3, 5).

Table 3. Some export/import indicators, in natural units

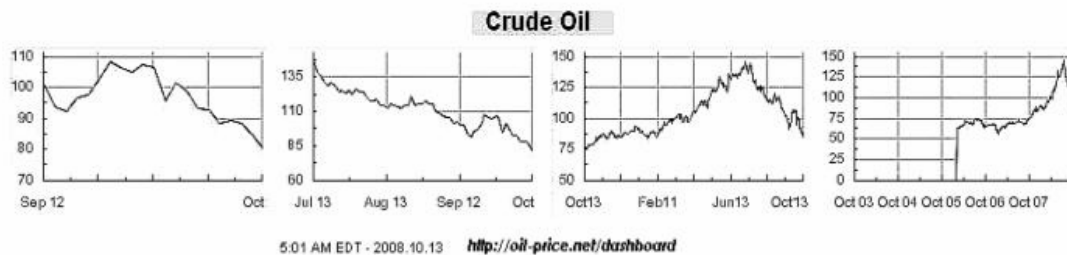
	2000	2005	2007
Crude oil imports, millions of tonnes	11.9	19.2	20.0
Oil product exports, millions of tonnes	7.8	13.5	15.1
Natural gas imports, billions of cubic meters	17.1	20.1	20.6
Potash fertilizer exports (on the primary nutrient basis), thousands of tonnes	2,840.2	4,288.7	4,354.0
Motorcar imports, thousands of units	57.7	131.3	180.4
Computer imports, thousands of units	1,001.6	738.1	1,747.4

Source: National Statistics Committee of the Republic of Belarus

The selected indicators showed a stable growth rate. Noteworthy also is the increase in consumption of imported crude oil on the home market and achievement of the “ceiling” consumption of natural gas.

Refined oil makes up most of Belarus’ exports (Table 2). As crude gets cheaper and cheaper as a result of the global crisis (Table 4), oil product prices and consumption volumes also go down. The country will import less crude oil and export less oil products (note that Russia will be receiving a bigger portion of the customs duty imposed on exports of oil products).

Table 4. Crude oil prices in the past month, quarter, year, five years

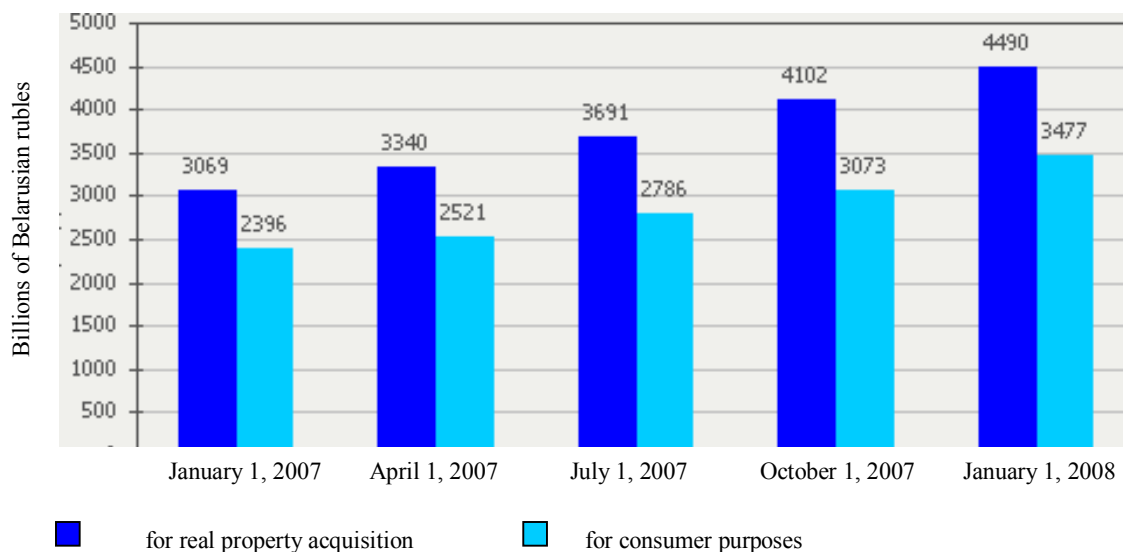


It becomes apparent that these trends are not to our good. The fact that oil is now cheaper, and natural gas will definitely follow suit, will hardly make it easier, because the **reduction in the foreign trade deficit will be immediately followed by a loss in Belarus’ competitive power, which is in direct proportion to the difference between the average gas price in Europe and on the border of Belarus.** The economic trouble of Russia’s Gazprom, the gas giant that has slipped into a colossal foreign debt against the value of its shares, which has dropped several times over the last couple of months, will scarcely prompt the gas monopoly to cut gas prices for Belarus. On the contrary, it is highly probable that Gazprom’s financial losses will be covered at the expense of neighboring countries, including Belarus. There is no chance of changing the structure of the fuel and energy balance overnight, either. One hope left for Belarus is the high ability to pay of consumers of our potash fertilizers from India, China, Brazil, the U.S. and Poland. Their financial soundness also depends on how fast the global market, and especially the main outlets for their exports – the U.S. and EU, gets over the crisis.

Finally, it is due to the crisis that neighboring states have been cutting jobs. As a result, Belarus’ construction sector has done away with the shortage of manpower. Inflows of funds from migrants are getting slower. When it comes to the so-called “authoritarian modernization”, it has remained a phantom of the official propaganda. Now that the crisis arose, it is possible for sales of our not very competitive mechanical engineering products to expand only within the former Soviet Union, and only under barter contracts. The long-awaited launch of high-tech modern productions in Russia, analogous to our manufacturers, will be a dangerous blow on this market.

Trap for Consumer Society: Accumulation of Debts

In the meanwhile, the Belarusians have entered the mass consumption phase (Tables 3, 5) and are now getting used to higher living standards. Mass consumption is encouraged by bank lending efforts. The credit market has expanded at an impressive pace over the past six months. Most of the borrowers are people aged 20 to 50 who had borrowed over 10 trillion Belarusian rubles by mid-2008, about 9% of last year’s GDP.

Table 5. Retail lending by commercial banks**Table 6****Gross External Debt of the Republic of Belarus 2003 – 2007**

millions of U.S. dollars

	01.01.2004	01.01.2005	01.01.2006	01.01.2007	01.01.2008
Gross External Debt	4,174.9	4,935.4	5,128.2	6,844.1	12,493.5
General Government	343.9	492.1	606.8	589.0	2,036.3
Banks	400.7	625.8	948.3	1,486.7	2,570.8
Other Sectors	2,853.6	3,402.5	3,219.1	4,368.0	6,782.0
Direct Investment: Intercompany Lending	293.0	338.2	353.3	399.7	508.2

Source: National Bank

The debt of the central government, commercial banks and enterprises was also growing. With the considerable share of the corporate debt, the short-term liabilities of the manufacturing sector are especially threatening. Combined foreign liabilities stand close to U.S. \$15 billion and keep growing.

The country has declared intentions to borrow another U.S. \$4 billion from Russia and the IMF, which, by the way, corresponds to the foreign trade deficit forecast in 2008. It should be noted that the evolution of the debt follows the well-known laws of discrete and limited resources. It means the phase, when the growth in the amount of debt and repayment cannot be regarded as a linear process, has finally been reached. It is clear from calculations that should the current growth rate remain unchanged, starting late next year, the size of the foreign debt will cyclically vibrate in the U.S. \$17 billion-U.S. \$20 billion range, because they will only lend us to refinance the debt we will have. If the borrowing pace continues long enough, the likelihood of cyclic fluctuations transforming into a chaotic wobble will be very strong. The government and private borrowers regulate the level of their liabilities and payment discipline proportionally to banks' money supply and following information reports about market trends.

The temporary measures the administration of the country is taking to mitigate the effects of the crisis are illustrated in the table below, which gives selected facts presented by the central bank. The decision of the head of state to guarantee all retail deposits with banks also belongs here.

Table 6. Measures taken by Belarus' administration

Refinancing Rate	
Valid since*	Value of base refinancing rate (discount rate), % per annum
2008	
15.10.2008	10.75
13.08.2008	10.5
01.07.2008	10.25

Book price of precious metals in bank ingots in August and November, Belarusian rubles				
	Gold, per gram	Silver, per gram	Platinum, per gram	Palladium, per gram
August 1, 2008	61,986	1,164	119,146	25,691
November 1, 2008	49,654	633	53,846	13,359

Exchange rate of the Belarusian ruble to the U.S. dollar, euro		
	August 1	October 1
U.S. Dollar	2,123	2,114
Euro	3,301	2,691

Source: National Bank

Ruble-denominated deposits rose 26% in the first nine months of 2008 to 9 trillion Belarusian rubles and U.S. \$2 billion. The temporary measures of the government were enough to restrain the enormous demand for foreign exchange at least for some time, although in some branches of economy demand exceeds supply ten times and more. Under the circumstances, banks are building up an "airbag" and in September alone, gold and foreign exchange reserves of the National Bank shrank by U.S. \$700 million to U.S. \$4.5 billion.

What can be done?

In conclusion, let's get back to the political rhetoric around the global turmoil. It is split into domestic populist declarations and external pragmatic claims. We can agree with pragmatism. The economy minister said: "Whether fortunately or unfortunately, Belarus is a country that remains underdeveloped from the point of view of international financial institutions. Shares of our companies have never been listed by transnational bourses, so we will not incur any direct losses. But on the other hand, the financial crisis will have an indirect impact: the demand for our products is falling on the Russian and other foreign outlets. We can forecast an objective reduction in sales of Belarusian products. Add restricted access to credit resources or necessity to borrow at exorbitant rates, hence slower modernization and problems with floating capital replenishment¹. The first assessments of foreign experts came in fast: Standard & Poor's Ratings Services downgraded Belarus' credit outlook to "negative". It means the global tendency towards insufficiency of credit possibilities will be further deteriorated for Belarus, which will find it harder or more expensive to borrow. Under the circumstances, the Belarusian authorities still have appropriate effective instruments to use:

¹ Latvia-Belarus 2008: Price of Reforms on Belarus' Account. Grigory Zubarev, New Radio FM 103.2, Riga-Minsk, October 20, 2008.

http://www.baltic-course.com/rus/baltija_sng/?doc=6294

1. Devaluation of the ruble. It would be a last-resort treatment for our administration, though. We reiterated in previous analyses of BISS and our partners that the stability of the exchange rate and people's confidence in the national currency were among the foundations of the "social contract" between the administration and society. The microcrisis of the Belarusian-Russian relations that arose in 2006-2007 brought about a run on banks, a severe blow with consequences grave enough to require temporary loans, which could only be repaid by privatization of Velcom mobile carrier. Despite the fact that the worst-case scenario in the development of "external" factors (oil prices, demand for Belarusian exports on the Russian market and availability of credit resources) will make ruble depreciation inevitable, the Belarusian authorities will only turn to devaluation as a last resort measure. Russian Urals oil blend quotations with delivery to Rotterdam on December 5 dropped 14.5% to U.S. \$35.6 a barrel, and to Augusta fell 16.2% to U.S. \$34.9 a barrel. The last time the Urals blend was traded below U.S. \$35 was back in July 2004. Devaluation is not even close.

2. Liberalization of economy. It has been declared, but it needs to be substantiated and legitimized. The process has started de-facto, once the head of state said it was not worth "dreading the open market". Paradoxically, the state leader offers such declarations as the U.S. elects a new president that is said to back redistribution of wealth. At the same time, temporary measures to curtail imports, such as the introduction of import markup caps, prove that full-scale liberalization is still very far. Concerned parties may wish to call the 100% guarantee of bank deposits of individuals an indication of liberal trends, as well as the U.S. \$1 billion contribution to Belagroprombank charter capital.

3. Privatization of state-controlled property. The poor access to credit resources and political inadvisability of ruble devaluation make privatization the key mechanism to ensure safety of the Belarusian economy. It must be emphasized that privatization is very likely to be held amidst a weaker demand for Belarusian assets and lower offering prices.

The future of the hundred and a half enterprises, included in the list passed by presidential ordinance #605 and subject to special procedure of transformation into joint-stock companies and further privatization, is getting vaguer as Russians seem to be losing their acquisition zeal.

The scandalous postponement of the Belarusian-Russian summit session and decision of Vladimir Putin to build an oil pipeline connecting Unecha and St. Petersburg are enough to discourage western buyers. The room for maneuver is getting narrower, and few possibilities are left, like an agrarian reform (channeling of social and economic ambitions) or reduction in grandiose investment plans, which will otherwise be very hard to finance using loans. This suggests that Belarus is finally faced with the situation when reform becomes indispensable. The government responds by tightening control and offering a non-surplus budget. Like they say: "No christening yet, but preparations are underway."